FY 2007

Idaho State Employee Compensation Report & Recommendations

Idaho Division of Human Resources, 12/1/2005

Report to the Governor

Idaho State Employee Compensation

Idaho Division of Human Resources

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I. Executive Summary

As required by Idaho Code 67-5309 A and B(c) and (d), the Division of Human Resources Administrator provides the Governor this annual report on state employee compensation and benefits and recommendations for change.

State Employee Salaries Significantly Below Market

The intent of the Legislature is that state employees may expect to advance in the salary range to the labor market average rate for the pay grade assigned to a classification. (Idaho Code 67-5309C(b)) To provide a market average pay rate, salary ranges need to be adjusted each year to reflect the increase in the market. Funding also needs to be provided to keep current employees' salaries at market. The market pay rate philosophy collapses when consistent funding is not available for these two key components. The challenge to fund state employee pay increases appears to have surfaced in 1980. The pay disparity has compounded each year the state has not funded market competitive employee pay increases.

For the compensation system to comply with current statute, the pay schedule structure must be maintained to reflect market average rates. Unfortunately, the pay range schedule, the state's salary structure, has not been maintained, due to the annual fiscal impact. Now, over two thirds of the state's positions have salary ranges below market, some by as much as 50%. The maximum salary amount for several pay ranges have fallen below market, making it impossible to comply with the statute.

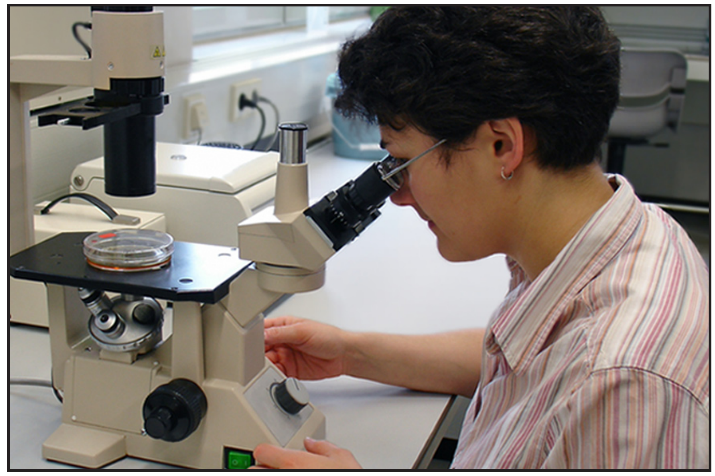
State employees' average salaries have also fallen significantly behind market. Because increases to base salaries were limited to salary savings this past year, the state has fallen behind an additional 2.3%. The state now lags the market by 16.5%.

A Constantly Changing Labor Market

Annual base salaries are constantly changing in the marketplace. Over the past 10 years, base salary increases in the marketplace have averaged over 3.7% a year. Within the State of Idaho wages increased an average of 4.2% according to the Idaho Department of Commerce and Labor's Average Weekly Wages report. State salaries will continue to fall further behind market unless salary increase budgets are established each year at or above the market average. The situation has now become critical because the impact of extremely low wages is increasing the cost of government in terms of turnover, training and quality of the workforce. Individuals with particular skill sets command a certain level of pay in the marketplace. Low unemployment rates mean effective and efficient employees have many job options. The state's workforce is directly impacted by economic laws of supply and demand.

Agencies Vary Widely when Compared to Market

There is a wide variance between state agencies in terms of market competitive position. Agencies' average pay levels range from slightly above market to 25% below market. Actual classifications range from 50% below market to 20% above market. To correct these issues, the solution must direct more funds to those positions and agencies furthest behind market.



Advancement in Pay Based on Performance

The current system has a significant amount of agency discretion. Agencies vary in their compensation policies and practices. Significant progress toward market competitive pay requires a more focused strategic effort. DHR recommends a merit increase matrix for base pay distribution. The proposed matrix takes into consideration four levels of performance, **and** where an employee is paid in the range. If properly funded, this approach will correct compression problems and improve the state's ability to keep its high performers. To maintain a skilled and engaged workforce, it is necessary to fund the performance based pay system annually.

Benefits

The major cost center for benefits for all employers is health insurance. The amount employers spend on health insurance premiums varies with the age of their workforce and claims experience. There are a number of factors impacting health insurance costs including plan design, availability and participation in network discounts, out-of-pocket costs for employees, and contribution levels for dependents. Since health insurance costs make up such a large portion of total benefit costs, the state, like all employers, needs to be vigilant in managing the benefit to maximize the return on the investment to the state and its workforce.

The state has traditionally offered a good benefit package, one that is designed to encourage and reward career public employees. This package includes health, dental, vision, life and disability insurance, retirement programs, paid holidays, sick leave, compensatory time off, and other paid leaves. Comparison of the state benefit package indicates that it is still competitive, other than the feature that requires a 90-day waiting period for health insurance coverage.

The retirement program for most employees is PERSI, which offers a lifetime benefit based on years of service and highest average earnings. Defined Benefit programs in general are becoming a challenge for more and more employers both in the public and private sector. PERSI has been consistently funded with safeguards built in to ensure adequate contribution levels.

Overall, the benefit package is still competitive, but does not exceed the market average packages anywhere near the levels required to compensate for the low base salaries and lack of funding for salary advancement. The entire benefit package cost has been kept whole during difficult budget years while salaries have not. Base pay and benefits are currently out of proportion in terms of a total compensation strategic approach.

Major Recommendations

Idaho Code states that employees should expect to advance to market average pay. It is the best way to ensure the taxpayers have the quality of state government program delivery that they expect. This administration, as well as the others before, has inherited this market wage lag, continuing expectations for correction, and the burden that the current benefit levels must not falter. Since 1994, the system has been one that requires no specific annual funding, and few requirements for market based distribution to employees. In hindsight, perhaps the 1994 system design was too broad, with too much discretion built in at the appropriation and allocation decision points. It has not produced the results that were intended. It is time to change.

DHR recommends a more strategic approach to CEC appropriations and allocation. A standard delivery of a flat CEC percentage increase will not be sufficient to address the problems with the system. Conservative, serious approaches, strategically aligned to improve the state's position to compete for staff who will deliver effective and efficient service, are what DHR recommends, including:

1. Increase the Salary Structure Pay Ranges so the midpoint is, on average, within 95% of market next year and at market within three years.
2. Increase the number of pay ranges from 24 to 31.
3. Budget a 5.7% overall CEC to fund merit increase and market equity adjustments.
4. Appropriate more funds to those agencies below market, less to those closer to market averages.
5. Implement a merit increase matrix that delivers greater increases to the best performers.
6. Incorporate the salary budget increase as a part of the agency budget development process.
7. Fully fund the health insurance cost increase, cover employees from the first of the month after hire. Conduct an eligibility audit.
8. Revise Idaho Code to state:
   a. Only employees with satisfactory performance are required to be paid within the range when there is a pay structure increase,
   b. Pay grade assignment is based on Hay Points and market rates,
   c. Market rates are set and certified by DHR,
   d. The number of pay ranges is set by DHR and will be focused on average labor market rates.
   e. Update bonus conditions and limitations.

Fiscal Impact

DHR suggests a strategic compensation plan that incorporates the recommendations above. For FY07, the total cost of the DHR recommendations for CEC is 5.7%. For each 1% CEC, the fiscal impact is approximately 5.8 million dollars in general funds. Because the recommendation focuses on several components that all align with a goal of bringing all employees closer to market average rates, the recommendations can all be achieved within this 5.7% or $33 million dollars for FY07.

Insurance premium increases are $5.8 million, the same amount as a 1% CEC. Additional recommendations to improve the effectiveness and efficiency of the state total compensation system are outlined in the following report.

Making Clear Progress

The recommended changes are creative, strategic, and will make the most of each taxpayer dollar directed to the state workforce. If adopted, internal equity for the state as one employer will be enhanced, and a total compensation policy is defined. New approaches will make significant progress, and implement the first step of a plan for a more competitive compensation package, one based on the goal to pay average market rates.

II. Purpose

This report is provided to the Governor on December 1st to fulfill the requirements of Idaho Code sections 67-5309 A and B(c) and (d). Idaho Code requires the Division of Human Resources Administrator to:

- Conduct or approve salary and benefit surveys,
- Compare state wages and benefits to average labor market rates within the public and private sectors,
- Report changes in the cost of living as measured by the CPI,
- Report anticipated adjustments in the average weekly wage in the State of Idaho, and
- Recommend changes in salaries and benefits, together with their estimated costs of implementation.

III. State Salary Increases Compared to Market Activity

One of the most widely used surveys of salary increase practices is conducted by World at Work (formerly American Compensation Association) representing approximately 13.9 million employees and 2,720 employers across the country. This survey provides a good cross section of employers in terms of type of industry, regions of the country, etc. World at Work conducts an annual salary increase survey. This survey covers a diverse cross-section of industries, including construction, manufacturing, transportation, publishing, information services, utilities, mining, health care, wholesale trade, retail trade, and the public sector.

The table at right includes a small sample of familiar public and private sector employers that participate in this survey.

This is the most widely used report for tracking annual movements in salaries and salary structures. The average structure increase and merit increase budgets for the employers listed would closely mirror the results of the survey.

As the chart below shows, the pay structure increase in the market has averaged more that 2.5% each of the past 10 years. The State

World at Work Survey Participants

24 Hour Fitness	Kelly Services
7-Eleven	Key Bank
Agrium	Marriott International
Albertsons	McDonald's Corp
Bechtel Nevada: Western Region	Mercy Hospital
Blue Cross of Idaho	Microsoft
Boise	Nestle
Boy Scouts of America	Nevada State Personnel
Brigham Young University	Office Max
CH2M Hill	Oregon Mutual
ConAgra Foods	Potlatch Corporation
Corrections Corp. of America	Qwest
Costco	St. Lukes Regional Medical Center
Direct TV	St. Alphonsus Regional Hospital
eBay	State Farm
FMC Corporation	State of Oregon
Franklin Covey	State of Utah
Idaho National Laboratory	The Regence Group
Idaho Power Company	University of New Mexico
Intermountain Helath Care	University of Arizona
Jack in the Box Inc	Wal-Mart
JC Penney	Washington Group
JR Simplot Company	

Historical Salary Structure Increases

Fiscal Year	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Salary Structure												Projected
Executives	2.4%	3.0%	2.6%	2.7%	2.7%	2.9%	3.0%	2.4%	2.2%	2.0%	2.2%	2.5%
Exempt Salaried	2.4%	2.9%	2.7%	2.9%	2.9%	3.0%	3.2%	2.5%	2.1%	2.0%	2.4%	2.5%
Nonexempt Salaried	2.3%	2.8%	2.5%	2.7%	2.7%	2.8%	3.1%	2.4%	2.3%	2.0%	2.4%	2.5%
State of Idaho	Hay	4.0%	3.0%	0.0%	2.0%	0.0%	5.0%	0%*	0.0%	0.0%	0.0%	0.0%

of Idaho has not increased its salary structure since 2001. The inability to do so seems to have short circuited current Idaho Code. The impact and concern is that some positions have salary ranges that are extremely below market.

Policy Ranges Lag Market

The surveyed job classes have "policy rates", also known as pay grade midpoints, ranging from 55% below market to several that are above market as illustrated in the sample of state positions in the chart below.

These are not average state employees' salaries, but a comparison of the state's pay grade "policy" target to the real labor market average rate. Average compa-ratios are 91%, but actual salaries average 83.5% of market rates.

Sample Range of Positions Compared to Market

Class Code	Classification	# Emps	Policy Annual	Market Annual Average	% Policy to Market
7404	Chemist, Principal	10	$42,016	$65,082	54.9%
3626	Drafter, Civil	1	$25,480	$37,411	46.8%
6538	Electrician	16	$32,032	$46,478	45.1%
7232	Epidemiologist, Staff	11	$45,697	$63,882	39.8%
3304	Geologist, Engineering	6	$49,982	$67,188	34.4%
8014	ISP Sergeant	37	$45,697	$60,589	32.6%
1619	IT Programmer Analyst	36	$42,016	$55,391	31.8%
7606	Nurse, Registered	123	$42,016	$52,559	25.1%
7720	Speech and Language Pathologist	9	$45,697	$56,584	23.8%
1532	Purchasing Agent	8	$49,982	$60,497	21.0%
4241	Financial Officer	9	$62,691	$74,946	19.5%
4675	Right-of-Way Agent, Senior	9	$49,982	$59,042	18.1%
8016	ISP Trooper	142	$42,016	$46,363	10.3%
7574	Nurse, Registered Senior	125	$45,697	$50,169	9.8%
1061	Lands Resource Staff Specialist	9	$49,982	$54,720	9.5%
9212	Correctional Officer	612	$32,032	$34,608	8.0%
6572	Locksmith	3	$28,641	$30,524	6.6%
2148	Dietary Services Manager	4	$58,489	$60,986	4.3%
6820	Clinician	213	$45,697	$47,282	3.5%
4338	Tax Auditor 1	10	$42,016	$43,071	2.5%
1239	Office Specialist 2	627	$25,480	$25,821	1.3%
8854	Commerce & Labor Consultant, Senior	219	$38,729	$38,530	-0.5%
9423	Social Worker	267	$42,016	$40,688	-3.2%
4248	Financial Technician	132	$32,032	$30,429	-5.0%
1586	Liquor Store Clerk	79	$22,921	$20,664	-9.8%
408	Toxicologist	1	$62,691	$52,126	-16.9%
836	Biologist, Staff	23	$54,953	$45,003	-18.1%
	Totals	**2741**	**$35,813**	**$39,090**	8.6%

The last column in the chart above indicates the percentage amount required to increase the "policy rate" to equal the average pay in the market. The extremes are so prevalent that a one-size-fits-all will not adequately address the issues.

Note that in a few jobs, the state's current "policy" target is above the average market rates.

Plan that Reflects Actual Market Targets

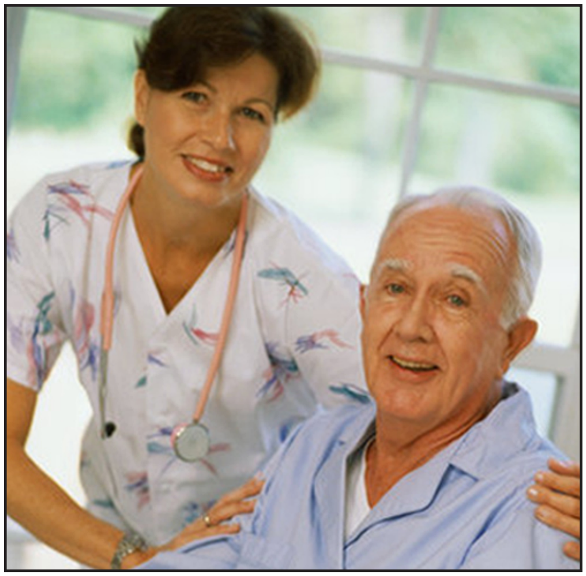
The state should adopt a plan to move the pay ranges and policy rate midpoints to market over the next several years. Many state agencies have severe pay level compression problems because the pay structures have not been moved with market and merit increases have been limited. In many cases, this means new, inexperienced employees are making the same salary as experienced, fully-proficient employees. This creates morale problems because employees realize that even though they perform well, they have not advanced in the pay range. Some employees feel betrayed and that the pay for performance commitment has been broken.

DHR recommends the state use a combination of Hay Points and market data to assign positions to a pay grade. DHR also recommends the state adopt a revised pay structure with 31 pay grades and smaller differentials between midpoint policy rates. This will improve the system in four ways: Hay Point factoring and market data would have a closer relationship; pay grade assignment would be more precise; midpoint would be more reflective of actual market rates; and salary compression would be minimized.

Any adjustment to the pay structure must incorporate a merit increase budget greater than the structure change percentage to avoid making compression problems worse.

Proposed Pay Grade Structure

Pay	Hay Points			Range	Range		Annual Pay			
Grade	Min	Mid	Max	Spread	Advance	% of Policy	Minimum	Policy	Maximum	% of Policy
20		99	101		7%	75%		$14,313	$17,891	125%
21	102	104	107	67%	7%	75%	$11,507	$15,343	$19,178	125%
22	108	110	113	67%	8%	75%	$12,363	$16,483	$20,604	125%
23	114	116	120	67%	8%	75%	$13,303	$17,738	$22,172	125%
24	121	124	128	67%	8%	75%	$14,332	$19,109	$23,887	125%
25	129	132	137	67%	8%	75%	$15,452	$20,602	$25,753	125%
26	138	142	148	67%	8%	75%	$16,666	$22,221	$27,776	125%
27	149	154	160	67%	8%	75%	$17,978	$23,971	$29,963	125%
28	161	167	174	67%	8%	75%	$19,393	$25,857	$32,322	125%
29	175	182	191	67%	8%	75%	$20,916	$27,888	$34,860	125%
30	192	199	209	67%	8%	75%	$22,553	$30,071	$37,589	125%
31	210	219	231	67%	8%	75%	$24,311	$32,415	$40,519	125%
32	232	242	255	67%	8%	75%	$26,198	$34,931	$43,664	125%
33	256	269	284	67%	8%	75%	$28,223	$37,631	$47,038	125%
34	285	300	318	67%	8%	75%	$30,396	$40,528	$50,660	125%
35	319	336	357	67%	8%	75%	$32,729	$43,639	$54,549	125%
36	358	378	402	67%	8%	75%	$35,236	$46,982	$58,727	125%
37	403	427	455	67%	8%	75%	$37,933	$50,577	$63,222	125%
38	456	484	518	67%	8%	75%	$40,838	$54,450	$68,063	125%
39	519	552	592	67%	8%	75%	$43,971	$58,628	$73,285	125%
40	593	632	679	67%	8%	75%	$47,358	$63,144	$78,930	125%
41	680	727	783	67%	8%	75%	$51,025	$68,034	$85,042	125%
42	784	839	907	67%	8%	75%	$55,006	$73,342	$91,677	125%
43	908	974	1054	67%	8%	75%	$59,339	$79,118	$98,898	125%
44	1055	1,134	1231	67%	8%	75%	$64,065	$85,420	$106,775	125%
45	1232	1,327	1443	67%	8%	75%	$69,237	$92,317	$115,396	125%
46	1444	1,560	1700	67%	8%	75%	$74,914	$99,885	$124,857	125%
47	1701	1,840	2011	67%	9%	75%	$81,164	$108,219	$135,273	125%
48	2012	2,181	2181	67%	9%	75%	$88,068	$117,424	$146,780	125%
49	2182	2,595	2595	67%	9%	75%	$95,721	127,627	$159,534	125%
50	2596	3,101	3101	67%		75%	$104,232	138,976	$173,720	125%



Overall, current pay structures would need to be increased approximately 8.6% for average policy rates to equal the average market rate. However, because of the wide variance in market competitiveness both across specific classifications and agencies, revisions to the pay structure and pay grade assignments must use a more strategic approach. DHR recommends adopting an approach for assigning positions to pay grade that adds market data information to the Hay factoring base. This would begin to correct some inequities in the pay range structure as compared to market. This would allow the state to correct situations where classes are significantly below market. The first year goal to attain 95% of market pay structures would require an average structure increase of approximately 3.6%. It will take several years for the state to achieve market parity using this approach. DHR would promulgate the rules to ensure market rates were determined in an unbiased, statistically valid manner. The initial approach DHR would take would be to review the Hay Point factoring for each job classification to ensure internal equity, and weight that factoring with 60% of the determination of pay grade placement, (rather than the current 100% basis). DHR would then calculate the market rate, and assign that value 40% of the determination. The overriding rule would be that pay structure increases could not move more than budgeted merit increase amounts. This allows a smooth transition without making the compression problem worse.

The following is an example of such an approach:

The Registered Nurse Job Classification

Hay Points	Pay Grade	Title	Annual Policy	Market Annual	% Policy Below Market
362	J	Registered Nurse	42,016	50,812	20.90%

Policy: 42,016 x 60% = 25,210
Market: 50,812 x 40% = 20,325
Policy + Market = 45,534
= Pay Grade K (midpoint 45,697)

This approach would not move the policy rate of all positions to market average rates the first year, but clear progress would be made. For these pay grade structure issues to be corrected, the annual merit increase budget must be adequate.

While the approach of weighting Hay Points and using market data to assign pay grades comes across as exact and definitive, in reality, properly factoring jobs and evaluating market data requires experience and good judgment. DHR will use market data and the Hay System as tools for properly assigning positions to pay grades. However, such assignments will be made collaboratively, within the limits of agency budget allocations, and in a way that does not increase agency specific compression issues.

Merit Increase Budget Recommendations

Employers have been spending on average 3.7% or more on merit increases each year over the past 10 years.

Market Salary Budgets

Fiscal Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Merit Increase Structure												Projected
Executives	4.10%	4.30%	4.50%	4.60%	4.50%	4.80%	4.70%	4.00%	3.60%	0.50%	3.80%	3.90%
Exempt Salaried	4.00%	4.10%	4.30%	4.50%	4.40%	4.60%	4.60%	3.90%	3.60%	3.60%	3.70%	3.80%
Nonexempt Salaried	3.90%	4.00%	4.10%	4.20%	4.20%	4.40%	4.40%	3.70%	3.40%	3.40%	3.60%	3.70%
State of Idaho	5.38%	1.00%	3.00%	0.00%	5.00%	3.00%	3.50%	3.50%	0.00%	0.00%	2.00%	0.00%

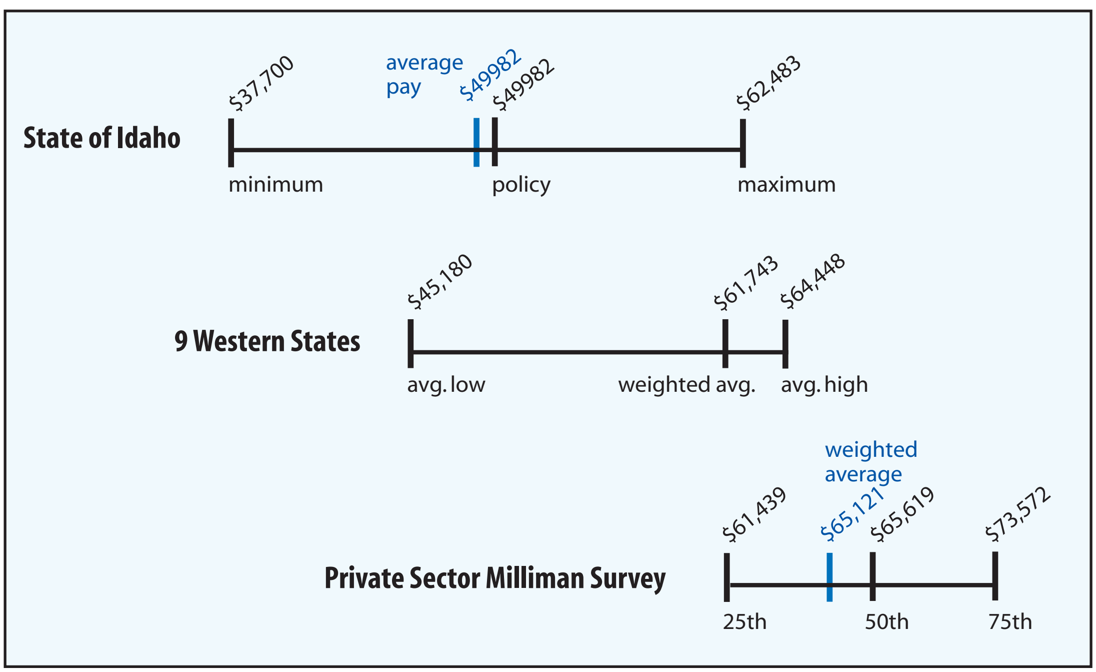
Every year the State spends less than the 3.7%, the state employees' average salaries fall further behind market. The 3.7% is a good measure of the average annual increase in the cost of labor. In recent years, labor costs have increased every single year. Disregarding the reality of annual increases in the labor market is comparable to someone opening a credit card account and not paying the bill in full. Initially the impact is not too noticeable, but over time the credit card bill increases, penalties are attached and the interest charged is increased, making it more and more difficult to get out from under this huge debt burden. Using that analogy, the state has now entered the penalty and higher interest phase. Those increased costs come in the form of losing some of the best employees and often filling those positions with less competent employees, who work less efficiently and require significantly more supervision and training. It also comes in the form of employees who stay but become less engaged because they feel a trust has been broken. To catch up to average market rates, merit increases must average more than 3.7% annually. If the state were to spend approximately 5.7% over the next 10 years, salaries would more-than-likely be at market. The state would need to spend approximately 7.7% over the next 5 years to reach market average.

IV. State Employee Pay Compared to Market

In recent years, most state employees' salaries have fallen significantly behind market. Last year the average state salary was 14.2% below market. Because increases to base salaries were limited to salary savings, the state has now fallen an additional 2.3% behind market. The state now lags the market by 16.5%. It would require an increase of 19.2% of base salaries or approximately 115 million dollars to bring the average salaries of employees to average market rates.

When an employer is trying to fill a position at the market average, that means that half of the available labor pool is already making more than the employer is offering. From one perspective, such an employer is competing for the bottom half of the labor pool. When an employer's actual recruiting salary is significantly below market, like the state, the available pool becomes much smaller. For those classifications with policy lines significantly below market, the state is relegated to competing for the bottom 5% to 10% of the labor pool or in many cases is forced to "under-fill" positions with people who need significant training and/or experience to be fully proficient. The cost of under-filling positions is often greater, to productivity, supervison and training, than paying an additional 10% to 15% to attract the more experienced, higher quality employees who are more proficient. Occasionally the state is able to hire outstanding individuals who are driven by a primary mission of contributing to public service, but this is usually after they retire from a more lucrative career. Recruiting these people has more to do with good luck and timing, than any market competitiveness on the state's part. Base salary issues are clearly non-competitive. The chart below reflects the state's current practice as compared to two market surveys for the position of Staff Engineer.

Staff Engineer



The state would have a very difficult time hiring any of the staff engineers included in the Milliman Survey since their average pay is above the maximum of the range for State of Idaho engineers. The bottom 25% of the employees in that survey would be paid above the average for the state. If the state were to hire one of them at their current pay level (unless they bring more experience with them than current staff) a compression problem would be created. The state would also have some difficulty attracting a staff engineer from a neighboring state unless living in Idaho was more important than base salary and/or projected salary rate increases.

Not only do individual classes vary in how they are paid compared to market, there are also rather extreme differences across agencies. Overall, the agency history of appropriations, political support and funding sources, as well as compounding market and turnover factors, have contributed to this problem over many years. Some refer to this issue with agency personnel budgets as the "haves" and "have nots". The results are illustrated in the chart below, and suggest an inequity in pay across the state, when the goal is market average comparison.

Agency's Average Salaries Compared to Market

Agency Name	# Classified Emps 11/1/05	Actual Annual Average	Market Annual Average	% Actual to Market
Water Resources	165	$36,891	$49,208	33.0%
Tax Comm	396	$27,421	$34,780	26.8%
Correction	1425	$29,843	$37,835	26.8%
Transportation	1732	$33,903	$41,683	23.0%
Environmental Quality	338	$44,829	$55,011	22.7%
Juvenile Corrections	326	$31,395	$38,438	22.4%
Parks & Recreation	148	$33,093	$40,190	21.4%
Commerce and Labor	653	$34,996	$40,689	16.3%
Lands	235	$34,496	$39,852	15.5%
Agriculture	197	$36,652	$42,059	14.8%
Health & Welfare	2816	$35,009	$39,881	13.9%
State Police	463	$41,403	$46,132	11.4%
Fish & Game	495	$38,224	$42,510	11.2%
Liquor Dispensary	166	$27,060	$29,323	8.4%
Totals	**13015**	**$32,518**	**$38,757**	**19.2%**

It would require a 33% increase to get Water Resources' employees average salaries to average market rates, while it would require an increase of 8.4 % to get the Liquor Dispensary employees average pay to market competitive levels.

To begin to correct this inequity, the state should appropriate a larger salary increase budget to those agencies with average pay furthest from market. The following chart is DHR's recommended approach that would direct larger salary increase budgets to agencies in greatest need.

Using this approach, all agencies would be given a base CEC increase of 2.25%. An additional budget allocation would be based on how far the agency is below market and the percent of jobs matched in the agency. The total CEC budget recommendation is 5.7%. Agency appropriations would vary from 2.25% to 7.8%. This amount would cover merit raises and implementation of the new pay grade salary structure.

Sample CEC Appropriation

Agency Name	# Classified Emps 11/1/05	# Emps Market Match	% of Positions Matched	Actual Annual Average	Market Annual Average	% Actual to Market	Maintenance Budget	26% of % Matched Positions * Distance from Market	Agency Allocation Percentage
Correction	1425	1132	79.4%	$29,843	$37,835	26.8%	2.25%	5.5%	7.8%
Transportation	1732	1364	78.8%	$33,903	$41,683	23.0%	2.25%	4.7%	6.9%
Water Resources	165	77	46.7%	$36,891	$49,208	33.4%	2.25%	4.1%	6.3%
Environmental Quality	338	222	65.7%	$44,829	$55,011	22.7%	2.25%	3.9%	6.1%
Tax Comm	396	200	50.5%	$27,421	$34,780	26.8%	2.25%	3.5%	5.8%
Juvenile Corrections	326	194	59.5%	$31,395	$38,438	22.4%	2.25%	3.5%	5.7%
Commerce and Labor	653	398	60.9%	$34,996	$40,689	16.3%	2.25%	2.6%	4.8%
Health & Welfare	2816	1940	68.9%	$35,009	$39,881	13.9%	2.25%	2.5%	4.7%
Parks & Recreation	148	63	42.6%	$33,093	$40,190	21.4%	2.25%	2.4%	4.6%
State Police	463	366	79.0%	$41,403	$46,132	11.4%	2.25%	2.3%	4.6%
Lands	235	131	55.7%	$34,496	$39,852	15.5%	2.25%	2.3%	4.5%
Agriculture	197	96	48.7%	$36,652	$42,059	14.8%	2.25%	1.9%	4.1%
Fish & Game	495	210	42.4%	$38,224	$42,510	11.2%	2.25%	1.2%	3.5%

V. Pay for Performance

In recent years, there has been little or no funding for performance increases. When increases have been granted, most have been across-the-board adjustments to all employees performing satisfactorily. While this is a form of pay for performance, it is likely not fulfilling legislative intent. When most employees within an agency are treated substantially the same in terms of pay, the cost for a competitor to attract the state's best employees is the same as it is to attract the state's average employees. Currently the state's best employees are most vulnerable to being lost to the competition. DHR has been working with agencies to enhance the quality of performance appraisals being conducted and improve consistency across state agencies. The new system has 4 categories of performance ratings[1]. A system that truly rewarded for performance would deliver the largest pay increases to the best performers. A merit increase matrix is a tool to deliver larger increases to the highest performing employees who are paid low in the range. The following is a sample merit increase matrix based on a 5.7% overall CEC.

Sample Merit Increase Matrix

Employee Ratings	Does Not Achieve Performance Standards	Achieves Performance Standards	Solid Sustained Performance	Exemplary Performance
Performance Percentage Guideline	3%	17%	60%	20%
Compa Ratio	**Percentage Increase**			
120% to 125%	0%	1.00%	2.00%	3.00%
115% to 119%	0%	1.70%	2.70%	3.70%
110% to 114%	0%	2.50%	3.50%	4.50%
105% to 109%	0%	3.10%	4.10%	5.10%
100% to 104%	0%	3.80%	4.80%	5.80%
95% to 99%	0%	4.50%	5.50%	6.50%
90% to 94%	0%	5.20%	6.20%	7.20%
85% to 89%	0%	5.90%	6.90%	7.90%
80% to 84%	0%	6.60%	7.60%	8.60%
75% to 79%	0%	7.30%	8.30%	9.30%

[1] See Supplemental Report for new performance rating levels and defining characteristics

Using such a matrix would serve to tie increases more closely to performance and market rate, and most importantly, clarify expectations from the Governor and Legislature for compensation policy execution. In the plan's first year, after pay grade structures are adjusted to 95% of market average, revised compa-ratios would be developed. Compa-ratio is a term used to describe where an employee is paid in the pay range in relationship to the midpoint. In addition, each employee would be evaluated in terms of a new performance management system of four levels:

- Exemplary Performance
- Solid Sustained Performance
- Achieves Performance Standards
- Does Not Achieve Standards

Agencies' decisions on how performance increases are awarded would be based on a matrix. Those employees with the highest performance rating and lowest compa-ratio would receive the largest increases. In some agencies with significant salary compression issues, DHR should work with the agency to develop a formula that would factor in performance in past years of experience to begin to correct situations where equity issues are severe. DHR recommends Idaho Code be changed to incorporate the suggested solutions. Proposed Code changes are delineated in the Supplement.

Cost of Living Raises Not Recommended

After several years of little or no base pay raises, some suggest a cost of living adjustment or COLA, based on the Consumer Price Index. This index has been reported to increase 3.3% in 2004 and 4.9% so far this year in 2005. However, it is important to take a closer look at this percentage figure. It is only relevant based on the context. The CPI is based on the increase of specific goods and services for urban consumers, wage earners, and clerical workers. In fact, for the family to be surveyed, more than half of the family's income must come from a wage or clerical job. The index is based on rent, not home owner's cost, and includes healthcare and tobacco products. The index became popular as part of union contracts for covered workers. It is not a good practice for Idaho state employees because it impacts individuals so disproportionately, and is unrelated to performance. It also encourages an entitlement mentality, and discourages motivation.

While there is no doubt state employees have lost purchasing power in recent years, a better solution is to focus on the market average rate for jobs. That rate will include what other employers have done to address the impact of inflation, as well as the laws of supply and demand for talent, skills, and abilities, on their workforce.

Market Issues and Executive Pay Levels

In recent years, the state has seen executives retire, and national searches for replacements. The new recruits are requiring much higher salaries than their predecessors. Several recruitments have been unsuccessful because the candidate needed $25-50,000 more in base salary than was possible. DHR recommends all jobs, classified and non-classified, have market survey data and Hay Point factoring analysis, and pay levels adjusted in the same manner as the classified service employees.

When salaries are adequate, the challenge of the mission, the nature of the work itself, and the opportunity to make a significant contribution to society are terrific motivators. The next Governor will face the challenge of recruiting executives to accept high levels of responsibility and continue to make improvements in state government. Low executive salaries not only make recruiting challenging, they create an artificial ceiling on other salaries. The "rainbow report" shows how many employees make more than the Governor, and how many make more than their agency directors. Adjustments are needed. Included in this recommendation is that salaries of elected officials be increased. Such legislation could be passed this year, but impact only those elected next fall.

Variable Pay Options

Variable pay tools, such as bonuses, short-term merits, or one-time pay increases, are important components of a compensation system. Such tools provide methods to reward performance, address short-term assignments, or compensate for special situations. In the labor market, bonuses are used for recruitment, rewards, and retention. To be effective, variable pay should have some relationship to base pay amounts. Therefore, DHR recommends a change in the bonus law to increase the maximum rate and set that rate as a percentage of base pay. Additional recommendations include adding recruitment, recognition and reward as rationale for bonuses. Additional language to allow for cash payments to employees in unusual or emergency circumstances is also recommended. See Idaho Code revision recommendations.

Results of the FY06 one percent, one time salary increase are in the Supplemental Report.

VI. Benefits

An important part of any compensation package is the level of fringe benefits. This year, DHR has studied how other states and private sector companies are handling the burden of providing health insurance benefits. The reason for this extra research is the direct relationship increasing benefits costs have had on the state's ability to offer market average salaries. Significantly more funding has to be provided for salaries, and perhaps, one source could be additional funding found by managing the benefit components differently.

There seems to have been a hesitancy to adequately fund base salary increases with the rationale that the state has a very good employee benefit package. In reality, the benefit package is fairly typical. The state's benefit package is similar to other states. When comparing the state's benefit package with the private sector, it is also typical with two possible exceptions. The contribution amounts employees pay for having dependents covered on the health plan is lower, and the amount the State contributes to the employee retirement program is greater.

DHR should identify specific employers that reflect who we attract employees from and who we lose employees to for benefit comparison purposes. This would further define the competitive market. Once this market is identified, DHR would conduct a calculation of the value of the state benefit package compared to those benchmark employers. This "valuation" of benefits does not compare the program offering or cost to the employer, but rather the value of the package to the employee in comparison to what competing employers typically offer. For example, the cost to the state for health care coverage may be more expensive than is typical in the market because of the age of the workforce, but the calculated benefit value to state employees may reflect the market. However, if a valuation analysis determined the benefit package as a percent of average salary is 5% above market, then the state's pay structure could be established at 95% of market. DHR recommends annually evaluating the total compensation package to determine a package that is most effective in attracting, retaining and motivating an effective, engaged workforce. This determination would be made by surveying representative samples of employees and job applicants.

For this year's survey, DHR analyzed available data; however, the Cross Industry Idaho Survey was discontinued by the sponsoring company. DHR used several other resources to survey benefit packages. The most significant finding is that costs of health insurance for public employees is determined by several factors, including:

- The amount of competition for the contract,
- If rural areas are covered,
- If the number of health care providers allows for competition,
- If benefit levels are part of a union contract and collectively bargained, and
- Political will.

It is misleading to look at benefit cost levels only for market comparison. A couple examples make those points clear. In Minnesota, all state employees are covered. This year, that state saw no increase in the cost of the health insurance. However, the state also allows for mail order prescription drug program, and encourages employees to purchase prescriptions from Canada.

In Oregon, the state still pays for 100% of the health care premiums, so employees pay no premiums. Their legislature provides the funding, but has little other control as all benefit packages are part of the collective bargaining agreements with the unions.

Several states did not choose to participate in Social Security years ago when the option was provided to the states. Their retirement programs and related health care appear richer, but those packages are attempting to compensate for that decision. Some state's health insurance covers domestic partners, including same sex partners. All state governments share the concerns that covering escalating costs of prescription drug coverage, and that their workforce is aging – two factors that seem beyond control. Each state needs to evaluate the benefit package design routinely to ensure it reflects the desired policies of the Governor and Legislature.

PERSI

The PERSI Board had made plans to increase contribution rates by a total of one percent. However, the Board approved a temporary rule delaying the contribution rate increases scheduled for July 1, 2006 and 2007, by one year to July 1, 2007 and 2008. This action added 6 months to the unfunded liability.

The Board also approved a COLA of 3.6% for PERSI retirees. Last year, most PERSI retirees received a 3.5% COLA. Active state employees have not received parallel increases.

Integrate Total Compensation Issues

A 90-day waiting period for health insurance was started a few years ago as a method to keep current employee premium increases flat while the cost of health insurance soared, and state employees were not seeing base pay raises. Unfortunately, a waiting period is only a market practice for low-skilled, part-time job markets, like retail and food service. Changing the start date for participation in PERSI

would shift the cost burden for the state, but not have the negative impact to recruiting that the health plan does now. PERSI participation would just be delayed. Another concept would be to delay PERSI participation until the classified employee has passed a six month probation period. PERSI historians relate that PERSI used to have a year waiting period. Once that was changed, employees could buy back that time.

DHR recommends integration of the decisions on benefit issues so PERSI costs and eligibility for new employees be incorporated, rather than just limit the fiscal impact discussion to health insurance. Early estimates indicate that a 90 day delay in state employees' eligibility for PERSI would save the state around $960,000 a year. This figure of almost one million dollars could be used to offset a change in the health insurance program to restore that benefit's competitive status.

Part Time Employees Total Compensation Package

Most benefits reflect a ratio or percentage of hours worked, such as vacation, sick leave, etc. Even the PERSI contribution is based on a percentage of actual pay. However, health insurance benefits are based on eligibility. The practice of the state to pay the same insurance benefits to employees who work only 20 hours a week and employees who work 40 hours a week has evolved into a gross inequity in total compensation per person.

To illustrate, an Administrative Assistant who works full time, earns $12/hour, for gross pay of $24,960 a year. His/her health insurance benefit is $7125 from the state, or an additional 29% of their compensation. Another Administrative Assistant works 20 hours a week for the same rate of $12/hour. His/her gross pay is $12,240. The state contributes the same amount, $7125 for their health insurance benefit. This benefit is 58% of their compensation. These two employees should be receiving equal pay for equal work, but their total compensation has become dramatically inequitable.

The issue of full time benefits for part time employees has taken on greater imbalance every year that the benefit costs were fully funded, and salary to market increases were partially or not funded at all.

A more equitable approach would be that the state's contribution to health insurance was pro-rated for part time employees. However, because insurance benefits can have such a significant impact to an individual that abrupt changes are not recommended. DHR recommends a **gradual phase-in of a new program over 2 to 3 years.**

A proposal for the pro-rated benefit could look like this:

a. Employees who work less than 20 hours per week, no benefits.
b. Employees who work 20 hours a week, would receive 50% of the state contribution for insurance (FY06 would be $3562.5)
c. 24 hours a week, would receive 60% of the state contribution (FY06 would be $4275)
d. 32 hours a week, 80% of the state contribution (FY06 $5700).
e. All 40 hour week jobs or full time salaried positions, 100% of the contribution (FY06 – $7125)

Employee contribution to premium costs would reflect the pro-rated levels. This would roughly be the premium they pay now, plus the percentage the state would no longer be paying. Each level could still have the discounts and coverage associated with the state's insurance design. The part time employees' contribution would be higher and proportionate to their percentage of full-time work.

There are currently 1830 part-time employees who are eligible to receive full time benefits. Interestingly, 476 of those have chosen to decline health insurance.

It appears that 1354 part time state employees receive full benefits. These insurance benefits cost the state roughly $9.7 million this year.

If a pro-rated benefit was phased in, a part time employee would have the opportunity to plan for the increased costs, seek full time employment with the state, or seek health insurance through a spouse's employer or other source.

When the program is fully implemented, a part time employee would still receive a generous contribution by the state for their health insurance, and would be able to take advantage of the state's rates.

Since the state currently pays 90% of the premium costs, the pro-rated share of the premium would be dramatically higher. However, the opportunity also exists for the state to offer another health insurance plan with much higher deductibles to reduce premium rates for all employees, but especially so there was an offering more affordable to part time employees.

If the health insurance benefits were pro-rated for eligible part-time employees, the state would save nearly $1.35 million on 20 hour employees and another $2,277,150 for the other part time people, for a potential $3.6 million savings in the state's share of health insurance premiums.

Surcharge for Tobacco Use

A surcharge for smokers or their dependents is the method some state governments are using to address the high cost of health insurance.

- Georgia began a surcharge July 1, 2005 of $40 a month on the insurance premiums if state workers or their covered family members use tobacco. The workers self-declare on an honor system basis. There are no mechanisms for testing for tobacco use. However, employees found to be concealing tobacco use risk losing medical coverage for one year.
- Alabama began charging $20 a month extra if they or their spouse use tobacco. Child dependents are exempt. The increases apply to all active and retired employees, and tobacco use is declared on a self-reporting basis. The state also offers a smoking cessation program.
- Kentucky, South Dakota, and West Virginia have or have plans to introduce different health insurance rate structures for smokers and non-smokers. South Dakota started this in 1997 and smokers pay $30 extra per month.
- Minneapolis-based General Mills, Inc. and Milwaukee-based Northwestern Mutual already have contribution differentials for smokers and non-smokers.

DHR recommends a similar program for Idaho state employees, one that includes smoking cessation programs. This move would be in line with the Governor's initiative to improve the health and fitness of all Idahoans, and reduce the risk for need of long-term care.

Reducing Ineligible Members Participation

DHR recommends a full or random audit of covered members in a state's health insurance program. Some employees and dependents enrolled in employer health plans may not be actually eligible; some are employees who work less than 20 hours, college students who are too old to be claimed as dependents, married children, common-law spouses, ex-spouses, or domestic partners. Other state HR directors have found this audit effective. The purpose of such an audit would be to reduce the amount the state needs for health insurance and free up those dollars for salary increases.

Health Insurance -- A Benefit, Social Policy or Both?

It is clear that the issue of health care and health insurance is critical public policy, and one that challenges the Governor and Legislature. However, Legislative intent should be clear when it comes to the significant amount of funds allocated to state employee health insurance costs -- is it social policy or total compensation or both? The state's decision to provide support so family coverage is more affordable to employees is an example of compensation and social policy.

Should the state consider a financial incentive for those who get their health insurance from another source? For example, if an employee would show proof of other insurance, some companies are providing a modest cash contribution to assist with the employee's premium or other out-of-pocket-costs.

Since 1998, the state contribution for health insurance has gone from $2964 per employee to $7125 for 2006 – a 245% increase. CEC salary increases have been funded during that same period with a cumulative 17% increase, while markets have increased 31% since 1998. This has resulted in a benefit package that tips the scales at 50+%.

The state's fringe benefits contain required and optional features, including: FICA, unemployment insurance, life insurance, health insurance, retirement, sick and vacation leave, and paid holiday time off. A forthright discussion of the state's position on health insurance provision is needed.

Average Base Salary for Classified Employees in State Departments and Agencies	$36,479
Average Fringe Benefit Costs	$19,850 or 54%
Average Base Salary for Non-classified Employees in Departments and Agencies	$51,217
Average Fringe Benefit Costs	$24,992 or 49%

VII. Summary & Recommendations

Significant funding must be directed to base salaries, as part of the first phase of a strategic compensation plan. A standard delivery of a flat CEC percentage increase will not be sufficient to address the problems with the system.

These conservative, serious approaches, strategically aligned to improve the state's position to compete for staff who perform effectively and efficiently, are practical and feasible.

Major Recommendations:

1. Increase the Salary Structure Pay Ranges so the midpoint is, on average, within 95% of market next year and at market within three years.
2. Increase the number of pay ranges from 24 to 31.
3. Budget a 5.7% overall CEC to fund merit increase and market equity adjustments.
4. Appropriate more funds to those agencies below market, less to those closer to market averages.
5. Implement a merit increase matrix that delivers greater increases to the best performers.
6. Incorporate the salary budget increase as a part of the agency budget development process.
7. Fully fund the health insurance cost increase, cover employees from the first of the month after hire. Conduct eligibility audit.
8. Revise Idaho Code to state:
   a. Only employees with satisfactory performance are required to be paid within the range when there is a pay structure increase,
   b. Pay grade assignment is based on Hay Points and market rates,
   c. Market rates are set and certified by DHR,
   d. The number of pay ranges is set by DHR and will be focused on average labor market rates.
   e. Update bonus conditions and limitations.

Fiscal Impact

The cost of the all DHR recommendations total a CEC of 5.7%. For each 1% CEC, the fiscal impact is approximately 5.8 million dollars in general funds. Because the recommendation focuses on several components that all align with a goal of bringing all employees closer to market average rates, the recommendations can all be achieved within this 5.7% or $33 million dollars for FY07. Insurance premium increases are $5.8 million, the same amount as a 1% CEC.

Additional Recommendations

Several different strategies are recommended to address the cost of total compensation, make progress toward a more competitive total package, and consider decision making and policy matters as they relate to benefit program management and design. In addition to the major recommendations, this year's research and analysis of public and private sector compensation and benefits administrations provided the following additional strategies. DHR also recommends:

1. Support of a 4 year strategic compensation plan.
2. All state jobs, classified, non-classified and cabinet level positions in the executive branch have a market survey data and Hay point factoring to assign pay ranges.

3. Salaries of Elected Officials need to increase, and should be treated as described in #2.
4. Benchmark employers be established as competitors, and a valuation of benefit packages be conducted.
5. Annual evaluation of the compensation package in terms of attractiveness to applicants and retention of current employees.
6. Integration of decisions on benefit issue program design.
7. A phase in a of pro-rated health insurance benefit for part time employees.
8. A surcharge be added to health insurance premiums for employees and their dependent who use tobacco products. This would be combined with additional support for smoking cessation programs.
9. An audit of covered members in the state's health insurance program to confirm eligibility.

These proposed changes are creative, effective, and will make the most of each taxpayer dollar directed to the state workforce. Internal equity for the state as one employer will be enhanced, and a total compensation policy is defined. New approaches will make significant progress, and a strategic plan for compensation will make the first important step forward.

VIII. Implementation Plan

Year One – FY07 Strategies

1. A minimum 5.7% CEC budget with individual agency appropriations based on distance from market.
2. Salary Structure changes from 24 to 32 pay grade ranges.
3. DHR assigns pay grade based on Hay Points and market data to achieve midpoints that reflect 95% of market average rates.
4. A merit increase matrix is used to award employee raises.

Projected Outcome: The average pay range would be at 95% of market and average salary would be 85.1% of market.

Year Two - FY08 Strategies

1. Benefit Package valuation completed.
2. Salary Structure calculated to reflect market average based on total compensation package.
3. The merit increase budget is two percent above salary structure increase.
4. Larger CEC budgets to agencies below market.
5. DHR adjusts pay grade assignments as market rates influence.

Projected Outcome: Structure is at 96% of market and average salary is at 86.8% of market.

Years Three, Four, and Five

Repeat strategies listed in Year Two. Outcomes outlined on the next page.

Note the annual increased required for both a 10 year and 5 year plan. Each year the cost of a 1% increase is compounded, as base budgets increase, and market rate targets advance.

Ten Year Plan

	Structure Market Movement	Idaho Structure Move	Idaho Structure as a % of Market	Merit Increase Market Movement	State Average Salary Increase	Average Salary as a Percent of Market	Market Salary	Average State Salary
Today			91.4%			83.5%	$41,750	$34,871
2007	2.25%	3.60%	95.0%	3.7%	5.7%	85.1%	$43,295	$36,859
2008	2.25%	3.75%	96.5%	3.7%	5.7%	86.8%	$44,897	$38,960
2009	2.25%	3.75%	98.0%	3.7%	5.7%	88.4%	$46,558	$41,180
2010	2.25%	3.75%	99.5%	3.7%	5.7%	90.2%	$48,280	$43,528
2011	2.25%	2.75%	100.0%	3.7%	5.7%	91.9%	$50,067	$46,009
2012	2.25%	2.25%	100.0%	3.7%	5.7%	93.7%	$51,919	$48,631
2013	2.25%	2.25%	100.0%	3.7%	5.7%	95.5%	$53,840	$51,403
2014	2.25%	2.25%	100.0%	3.7%	5.7%	97.3%	$55,832	$54,333
2015	2.25%	2.25%	100.0%	3.7%	5.7%	99.2%	$57,898	$57,430
2016	2.25%	2.25%	100.0%	3.7%	4.5%	100.0%	$60,040	$60,014

Five Year Plan

	Structure Market Movement	Idaho Structure Move	Idaho Structure as a % of Market	Merit Increase Market Movement	State Average Salary Increase	Average Salary as a Percent of Market	Market Salary	State Salary
Today			91.4%			83.5%	$41,750	$34,871
2007	2.25%	3.60%	95.0%	3.7%	7.5%	86.6%	$43,295	$37,486
2008	2.25%	3.75%	96.5%	3.7%	7.5%	89.8%	$44,897	$40,298
2009	2.25%	3.75%	98.0%	3.7%	7.5%	93.0%	$46,558	$43,320
2010	2.25%	3.75%	99.5%	3.7%	7.5%	96.5%	$48,280	$46,569
2011	2.25%	2.75%	100.0%	3.7%	7.5%	100.0%	$50,067	$50,062